Supreme Court, U. S.
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IN THE

Supreme Court of the United States

OCTOBER TERM, 1976

No. 76-975

ARTHUR L. WINN, JR. AND SADIE N. WINN,
Petitioners

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

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IN THE
SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1976

No.

ARTHUR L. WINN, JR. and
SADIE N. WINN, Petitioners

v.

COMMISSIONER OF INTERNAL
REVENUE, Respondent

PETITION FOR A WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF
APPEALS FOR THE FOURTH CIRCUIT

Petitioners, Arthur L. Winn, Jr. and Sadie N. Winn, petition for a writ of certiorari to review a judgment of the United States Court of Appeals for the Fourth Circuit entered November 8, 1976 in Arthur L. Winn, Jr. and Sadie N. Winn v. Commissioner of Internal Revenue, No. 76-1172.

OPINIONS BELOW

The opinion of the Court of Appeals is not officially printed. The opinion appears in the Appendix hereto. The opinion of the Tax Court is not officially printed. It also appears in the Appendix hereto.

JURISDICTION

The judgment of the Court of Appeals was entered on November 8, 1976. The Court denied appellants' petition for rehearing on December 14, 1976. This Court has jurisdiction under 28 U.S.C. 1254(1).

QUESTIONS PRESENTED

During the years 1964, 1965 and 1966, taxpayer had loaned Rockland Radio Corporation approximately $150,000. At the close of the tax year 1966, Rockland had reached a state of complete financial

collapse. At that time Rockland had $74.00 in the bank; it had exhausted all sources of credit; it had no funds to continue operations, and if it ceased operations the Federal Communications Commission most probably would revoke its broadcast license under the provisions of the Federal Communications Act (47 U.S.C. 312(a)(3))[1/]. Rockland had large liabilities ($133,000) having clear priority over its debt to the taxpayer. In contrast, Rockland had salable assets worth $45,000 at most. Rockland was continuing to suffer large operating losses every month.

1/ See, e.g., Cancellation of the Outstanding License of Turner Whitefill Broadcasting Co., 24 F.C.C. 830 (1970)

The questions presented are:

1. Whether the conduct of the taxpayer in years subsequent to the tax year seeming to indicate that he had some hope of recovering the business debt involved may properly be relied upon on as the sole basis to rule that the debt did in fact have value at the close of the tax year?

2. Whether an objective test of sound business judgment based upon facts known at the close of the tax year should be applied in determining worthlessness of a business debt?

3. Whether the financial collapse of Rockland Radio Corporation at the close of the tax year rendered its debts to the taxpayer worthless in 1966 even though unforeseeable events permitted the

corporation to continue to operate, albeit in a hopelessly insolvent condition?

STATUTORY PROVISIONS INVOLVED

The statutory provision involved is Section 166(a)(1) of the Internal Revenue Code (26 U.S.C. 166(a)(1)) which provides:

> "There shall be allowed as a deduction any debt which becomes worthless within the taxable year."

STATEMENT OF THE CASE

The Proceedings Below

The petition of the taxpayers was filed with the Tax Court on June 25, 1970, and was amended at the time of trial. The trial before the Tax Court was held September 22, 1972. The opinion of the Tax Court (App. 1) was issued June 30, 1975, and, following denial of taxpayers' petition for Further Trial for the receipt

of additional evidence, was entered October 16, 1975. The opinion of the Tax Court states that "there are deficiencies in income tax due from the petitioners for the taxable years ending December 31, 1963, December 31, 1964, December 31, 1966 and December 31, 1967, in the amounts of $14,781.45, $21,316.82, $16,352.28 and $821.40 respectively." The major part of the deficiencies is attributable to the Court's denial of a bad business debt deduction claimed by taxpayers, namely, a deduction of $150,826.49 in the tax year 1966 with a related loss carry back in the years 1963 and 1964; the remainder of the deficiencies not being in dispute.

Notice of appeal from the Tax Court decision was filed with the Fourth Circuit Court of Appeals on January 8, 1976. On November 8, 1976, the Court of Appeals issued a per curiam decision affirming the Tax Court decision in all material respects. (App. 32) On December 14, 1976, the Court of Appeals denied appellants' petition for rehearing. (App. 36)

REASONS FOR GRANTING THE WRIT

1. Conflict With Other Circuits, The Court Of Claims, And Decisions Of This Court

The decision of the Fourth Circuit creates a clear conflict among the circuits with respect to interpretation of Section 166(a)(1) of the Internal Revenue Code. In its per curiam decision the court referring to taxpayer's actions in years subsequent to the tax year 1966 held at sheet 3:

> "The Taxpayer's own conduct, including continual and sizeable cash advances to the debtor corporation, the rejection of an offer of sale of the station, and his letter to a bank indicating that he hoped that the radio operation would be profitable within a short time, supports the conclusions of the Tax Court."

Similarly, the opinion of the Tax Court places controlling importance upon the subjective hopes of this particular taxpayer. This reliance upon the hopes for recovery by an individual taxpayer stands in marked contrast to the Tenth Circuit case of Denver & Rio Grande Railroad Company v. C.I.R., 279 F.2d 368, 375 (C.A. 9, 1960) where the court held:

> "However, value cannot be based on hope alone. The statute requires the objective test of when, in fact, the bonds became worthless and not the subjective test of the taxpayer's reasonable and honest belief of worthlessness."

The opinions below of the Tax Court and the Fourth Circuit reject the objective factual test employed by the Tenth Circuit in Denver & Rio Grande. They similarly conflict with the decision of the full bench of the Court of Claims in Minneapolis, St. Paul & Sault Ste. Marie R.R. v. United States, 13 AFTR 2d 472, 479 (1964) where it was held:

> "To be deductible, a debt need not be proven worthless beyond all peradventure, since a bare hope that something might be recovered in the future constitutes no sound reason for postponing the time for taking a deduction. [Citations omitted] The taxpayer is not required to postpone his entitlement to a deduction in the expectancy of uncertain future events nor is he called to wait until some turn of the wheel of fortune may bring the debtor into affluence."

The Tenth Circuit in Denver & Rio Grande, and the Court of Claims in

Minneapolis St. Paul were consistent with the decision of this Court in United States v. S. S. White Dental Manufacturing Co., 274 U.S. 398 (1927). White Dental involved a situation where the taxpayer hoped to recover assets seized by the German government during wartime. The taxpayer worked diligently in years subsequent to the tax year to recover the assets, and, appeared to be on the brink of recovering its losses. This Court, however, held that the objective facts viewed at the close of the tax year indicated worthlessness, and, accordingly, the hopes and subsequent conduct of the taxpayer could not be controlling.

In this case, both the Tax Court and the Fourth Circuit place controlling importance upon the conduct of the tax-

payer in subsequent years, and totally disregard the objective facts at the close of the tax year.

2. The Decision Below Makes Orderly, Consistent Application Of Section 166(a)(1) Of The Internal Revenue Code Impossible

Prescinding from the unjust consequences of the decision below with respect to the taxpayers involved, the rule of law espoused will have a far reaching effect upon all taxpayers.

Admittedly, the determination of whether a debt becomes worthless within a tax year is essentially a question of fact which must be determined on the basis of the circumstances surrounding each case. Up until now, however, each case could be viewed on the basis of an objective standard of "sound business judgment."

Minneapolis, St. Paul & Sault Ste. Marie R.R. v. United States, supra, at 479. The decision of the Fourth Circuit here, however, virtually eliminates that objective standard, and substitutes therefor a totally subjective test. Accordingly, each case would be decided based upon the optimism or pessimism of the individual taxpayer involved.

The orderly and consistent application of the tax laws will not permit such a subjective and varying interpretation. Each taxpayer would have his tax liability determined not by consistent objective standards, but rather, by an attempt by the Commissioner to divine the taxpayer's subjective state of mind. The rule applied below would operate to treat tax-

payers inconsistently, and to deny to many their rights under the statute.

CONCLUSION

For the foregoing reasons, a writ of certiorari should be granted.

Respectfully submitted,

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Attornev for Petitioners

January 13, 1977

APPENDIX

T. C. Memo. 1975-213

UNITED STATES TAX COURT

ARTHUR L. WINN, JR. and SADIE N. WINN,
Petitioners

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent

Docket No. 4059-70. Filed June 30, 1975.

Arthur K. Mason, for the petitioners.

Shepherd S. Neville, for the respondent

MEMORANDUM FINDINGS OF FACT AND OPINION

GOFFE, Judge: The Commissioner determined deficiencies in petitioners' Federal income tax as follows:

Taxable Year	Deficiency
1963	$14,781.45
1964	21,316.82
1966	19,676.99
1967	1,613.17

The years 1963 and 1964 are involved solely by reason of claims for net operating

losses carried back from 1966. The issues for decision are whether advances made by Petitioner Arthur L. Winn, Jr. to Rockland Radio Corporation were business or nonbusiness bad debts worthless or partially worthless in 1966 or 1967, contributions to capital worthless in 1966, or ordinary and necessary business expenses deductible in 1966. Other adjustments made in the statutory notice of deficiency have been settled.

FINDINGS OF FACT

Some of the facts have been stipulated. The stipulation of facts, supplemental stipulation of facts and exhibits are incorporated by this reference.

Petitioners Arthur L. and Sadie N. Winn, husband and wife, filed their joint Federal income tax returns for the taxable

years 1963, 1964, 1966 and 1967 with the District Director of Internal Revenue, Baltimore, Maryland. They resided in Brinklow, Maryland, at the time they filed their petition.

Arthur L. Winn, Jr. (hereinafter petitioner) has been engaged in and specialized in the practice of transportation law in Washington, D.C., for 44 years and still devotes the majority of his time to the practice of law.

Petitioners' son, Anthony T. Winn, became active in the field of radio broadcasting in 1959 as a management trainee with station KABL in San Francisco, California. Subsequently, he was associated with station WMAL in Washington, D.C., and station WSVA in Harrisburg, Virginia. He became interested in making broadcasting

a career and, in 1960, persuaded petitioner to join him in a Federal Communications Commission (FCC) application to construct and operate a radio station. Anthony Winn was without financial resources and requested petitioner's participation to demonstrate financial backing on the FCC application.

Petitioners' son made a study of economic information, family income, competitive stations, growth rate and other factors in many communities throughout the United States in order to select the most desirable community. Rockland County, New York, was selected and petitioner visited Rockland County and was impressed with its prospects for growth. Aside from its prospect as a radio station site, the real estate in the county appeared to be a very promising and attractive investment

to petitioner.

On January 12, 1961, petitioner acquired approximately three acres of unimproved commercial property on the main thoroughfare in Rockland County. This property eventually became the site for the structure housing the radio broadcast facilities, hereafter referred to as Broadcast House. Petitioner's purchase of the real property was influenced to a certain extent by his knowledge of the fact that a nationally known retail chain was planning a shopping center nearby. He also discovered that local planning authorities considered the thoroughfare to be the center of commercial retailing in the county. On May 3, 1961, petitioner executed a lease for approximately five acres for a term of 21 years at a net an-

nual rental of $16,000, plus taxes. The five acres were adjacent to the Broadcast House property and were intended as a site for the broadcast towers, hereinafter Tower Land. On May 26, 1961, petitioner acquired five acres near the Tower Land and Broadcast House property which was referred to as the Stark Tract. An additional two acres of the Stark Tract were acquired on or about January 1, 1963.

On November 3, 1960, petitioner and Anthony Winn filed an application with the FCC as a partnership to obtain a license to construct and operate a radio station in Rockland County, New York. They were advised by their counsel for FCC matters that the inclusion of local interests in their application would enhance the likelihood of a successful application. Two

reputable local businessmen were asked and agreed to join the venture. To this end, Rockland Radio Corporation was organized under the laws of the State of New York on May 19, 1961. The original FCC application was amended on June 6, 1961, to substitute Rockland Radio as the applicant. The original directors, officers and subscribers of the stock of Rockland Radio were as follows:

		No. of Shares Subscribed at $100 per Share
Anthony T. Winn	President	120
A. L. Winn, Jr.	Secy-Treas.	60
Jay Northrup	V. President	30
Jacob Pesner	V. President	30

The shares were in fact paid for in November and December 1964 and January 1965.

Petitioner's plans for the Broadcast House property included the building of a

two-story structure; renting the second floor to the radio station for broadcasting facilities; renting the first floor to stores and offices; and leasing approximately two-thirds of an acre of the remaining land to the radio station to provide space for the wire between Broadcast House and the radio towers on Tower Land. The forecast annual net rental from the Broadcast House property was $35,000 composed of $18,000 from the second floor broadcast facilities, $2,000 for the easement for the underground wires, $15,000 from first floor rentals. The forecast net cash remaining after payment of the principal and interest on the construction mortgage and operating expenses ranged from $7,700 to $15,000.

On February 17, 1964, the FCC rendered a favorable decision which became

final and effective September 17, 1964. After the tentative favorable decision, Anthony Winn commenced planning for the construction of the towers, installation of the ground system and purchase of the needed equipment. On January 20, 1965, the board of directors authorized Rockland Radio to purchase a tower and transmitting equipment from Gates Radio Company for $64,462.16 composed of $22,000 in cash with the balance financed by a conditional sales contract guaranteed by petitioner and Anthony Winn. On February 5, 1965, Rockland Radio executed a loan agreement with Bankers Trust Company, guaranteed by petitioner and Anthony Winn, for a loan of $75,000 to be advanced from time to time thereafter and prior to September 30, 1965, to provide working capital and for

the purchase of equipment. Under the Bankers Trust loan agreement, Rockland Radio was not permitted to "[c]reate, incur or assume any liability for borrowed money or advances" from anyone other than petitioner nor was Rockland Radio allowed to make repayments to petitioner while the Bankers Trust obligation was outstanding. The guaranty provided that the guarantor could be called upon for payment if the borrower suspended operations. On February 18, 1965, petitioner applied to County Trust Company of Tarrytown, New York for a construction loan of $175,000 covering the construction costs of Broadcast House. The total cost to construct Broadcast House was $224,150.24, with the amount in excess of the $175,000 construction loan supplied by petitioner personally. On

June 18, 1965, petitioner leased the second floor of Broadcast House to Rockland Radio for a term of 17 years at an annual rent of $18,500. On the same day, petitioner subleased the Tower Land to Rockland Radio for a term of 18 years at an annual rent of $18,560.85 accruing from February 1, 1964.

At Rockland Radio's board of directors meeting on May 25, 1961, a general discussion of the financial needs of the corporation disclosed a contemplated need of $70,000 cash and $24,000 in equity capital. Petitioner agreed, if necessary, to lend the corporation $46,000. On October 17, 1964, petitioner agreed to lend the corporation $26,000. Anthony Winn's planning indicated that Rockland Radio would be self-supporting after three

months of operations. Petitioner made the following advances to Rockland Radio during the years 1964 through 1967:

	1964	
Month	Amount	Maturity
May 1	$ 3,000.00	5/1/67
October 13	6,626.49	10/13/67
October 17	2,000.00	10/17/67
November 3	10,000.00	11/3/67
December 31	700.00	12/31/67
December 31	14,000.00	12/31/67
	$ 36,326.49	

	1965	
December 1	$ 5,000.00	12/1/68
December 31	10,000.00	12/31/66
	$ 15,000.00	

	1966	
January 28	$ 10,000.00	1/28/67
February 21	10,000.00	2/21/67
March 23	20,000.00	3/23/67
May 12	10,000.00	5/12/68
June 24	10,000.00	6/24/68
July 29	10,000.00	7/29/68
August 19	5,000.00	8/19/68
September 1	5,000.00	9/1/68
September 16	10,000.00	9/16/67
October 5	4,500.00	10/5/67
December 20	5,000.00	12/20/67
	$ 99,500.00	
	$150,826.49	

All the advances were evidenced by notes maturing from one to three years from the date of the advance with interest at 6 percent. The 1967 advances were as follows and were also evidenced by notes:

1967	
Month	Amount
January 6	$ 2,000
January 28	5,000
March 3	2,000
March 31	6,000
April 14	3,500
May 5	4,000
May 29	4,000
June 7	5,000
June 22	5,000
July 17	3,000
July 20	6,750
August 22	3,000
September 11	5,500
September 25	1,500
September 27	325
October 6	3,000
October 20	1,000
November 17	3,000
December 7	2,500
December 14	5,000
December 26	2,500
	$73,575

Neither the principal nor the interest on

such notes or advances was ever paid. After 1967, petitioner continued to make advances to Rockland Radio.

Rockland Radio went on the air in temporary studio quarters on the Stark Tract in September 1965. Broadcast House was completed and Rockland Radio commenced occupancy in June 1966. The design of the radio antenna system for Rockland Radio by an engineering firm anticipated a broadcast reception pattern providing reception for listeners throughout Rockland County, New York. This projected broadcast reception pattern was based upon ground conductivity data provided by the FCC. Upon commencement of broadcasting, it was discovered that peculiar soil conditions produced a lower ground conductivity, and, consequently, the broadcast

area was less than anticipated. The same engineering firm was employed to study the situation with a view to designing and requesting FCC authorization to employ a different radio broadcasting pattern to provide greater and stronger reception as originally anticipated. A revised pattern was prepared and filed with the FCC with the request that it be authorized. Such authorization was received from the FCC in March of 1966, and the revised broadcasting pattern was used in the spring of 1966 and finally approved by the FCC in September 1966. The revised broadcasting pattern was still not as extensive or satisfactory a pattern as the original anticipated pattern. At the time the station went on the air, it had $25,000 in advance sales spread over a six-month

period. However, after it went on the air and its signal problem was discovered, businessmen in the community stopped the advertising which they had previously agreed to and were very reluctant to buy any time on the station. Even though the signal was substantially improved by the revised broadcast pattern, the corporation was unable to eliminate the stigma from the original signal problem. Gross revenues increased but only at the cost of great sums for sales promotion and the station continued to operate at a loss.

During 1966, Rockland Radio's communications attorney advised petitioner and his son that sale of the station including the broadcasting license was, for all practical purposes, not feasible due to FCC regulations prohibiting sales within three

years from the time of initial broadcast. As of December 31, 1966, a certified balance sheet for Rockland Radio disclosed assets of $145,135.06 and liabilities of $369,194.41. Petitioner was unable to find additional funds and Bankers Trust refused to lend any more money to Rockland Radio.

In March of 1967, Anthony Winn's mother-in-law, Mrs. Hare, advanced $73,575 to petitioner secured by a second mortgage on Broadcast House. The loan was conditioned upon petitioner advancing the proceeds of the loan to Rockland Radio and Mrs. Hare being able to purchase the 25 percent interest in Rockland Radio owned by Mr. Pesner and Mr. Northrup. Petitioner had guaranteed Messrs. Pesner and Northrup that they would not lose their

$3,000 investment in Rockland Radio and the stock was purchased for $6,000 by Mrs. Hare in 1967. On December 31, 1967, a certified balance sheet for Rockland Radio disclosed assets of $121,491.06 and liabilities of $466,356.18. Both the 1966 and 1967 balance sheets listed the value of the broadcasting license to be $33,431.38, the same amount which was payable to Rockland Radio's FCC counsel for securing the license.

A new manager was employed by Rockland Radio on January 1, 1968. At that time, the broadcast format was changed from "Top 40" to a new format placing emphasis on local news. The station's call letters were also changed. In a letter dated February 16, 1968, petitioner requested a personal loan of $50,000 from

Bankers Trust Company, the proceeds of which he proposed to advance to Rockland Radio. He represented that he believed that the additional money and the new manager would either provide profits of $50,000 per year within two or three years or a $500,000 sales price when sold. He estimated the station's value to be $250,000 on February 16, 1968.

In early July 1968, petitioner received an unsolicited offer to purchase Rockland Radio's assets for $350,000 subject to certain conditions including the inspection of the financial statements. A second offer by the same individual for $275,000 was made in September after he became familiar with Rockland Radio's income statement. Rockland Radio rejected the offers because petitioner was not interested in selling.

On their joint income tax return for the taxable year 1966, petitioners claimed a deduction for worthless business bad debt for advances to Rockland Radio aggregating $150,826.49.

In his statutory notice of deficiency, the Commissioner determined that petitioners' claimed business bad debt for the taxable year 1966 of $150,826.49 was a contribution to capital. In the event that the advances constituted debt, he further determined that the bad debts were nonbusiness. In addition, he determined that such advances were not fully or partially worthless in the taxable year 1966.

OPINION

Petitioner contends that advances of $150,826.49 to Rockland Radio made from

May 1, 1964 through December 20, 1966, were deductible in the taxable year 1966 or 1967 as totally worthless business bad debts under section 166(a)(1), Internal Revenue Code of 1954, or as partially worthless business bad debts under section 166(a)(2). He further claims the $150,826.49 as a worthless security loss under section 165(g) or as section 162 ordinary and necessary expense in carrying on his trade or business as a real estate landlord-developer in the taxable year 1966.

Respondent contends that the transfers were contributions to capital rather

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1/ All Code section references are to the Internal Revenue Code of 1954 in effect during the years in issue, unless otherwise noted.

than debt. Further, assuming the transfers gave rise to valid debt, he contends that the debt created was nonbusiness rather than business and, in any event, neither the stock nor the debts became worthless in 1966 or 1967.

Petitioner has the burden of proving that either the debt, W. B. Mayes, Jr., 21 T.C. 286 (1953), or the stock, Boehm v. Commissioner, 326 U.S. 287 (1945), became worthless in 1966 or 1967. It is generally accepted that a debt becomes worthless in the year in which identifiable events clearly mark the futility of any hope of recovery. Denver & Rio Grande Western Railroad Co. v. Commissioner, 279 F.2d 368 (10th Cir. 1960), affg. 32 T.C. 43 (1959); James A. Messer Co., 57 T.C. 848 (1972). Likewise, identifiable events

evidencing the lack of liquidating or potential value determine the worthlessness of stock. United States v. S. S. Dental Manufacturing Co., 274 U.S. 398 (1927); Charles W. Steadman, 50 T.C. 369 (1968), affd. 424 F.2d 1 (6th Cir. 1970), cert. denied 400 U.S. 869 (1970). Under either test, we find petitioner has failed to focus our attention on any identifiable events which are sufficiently clear to permit deduction in either 1966 or 1967.

Initially, petitioner relies in part on the fact that liabilities were so far in excess of assets that there was no reasonable hope or expectation of recovery of the debt or, with respect to the stock, that it had no liquidating or potential value. Although the unsolicited offers to purchase the station's assets came in July

of 1968, it is not uncommon to take cognizance of subsequent events. See, e.g., Trinco Industries, Inc., 22 T.C. 959, 965 (1954). In this instance, the certified balance sheets for December 31, 1966 and 1967, recite the value of the FCC license to be $33,431.38--the cost of the legal services attributable to the acquisition of the license.

Notwithstanding the fact that the FCC would not permit sale of the license until three years after it was granted, i.e., September 1968, it probably had value greater than its cost. See, e.g., Richard R. Riss, Sr., 56 T.C. 388, 409 (1971). Such hidden value is supported by the unsolicited offer to purchase the station's assets for $350,000, subsequently reduced upon further knowledge of the of-

feror to $275,000 which the December 31, 1967 balance sheet listed the value of the assets at only $121,491.06. Consequently, as of December 31, 1967, with total liabilities, exclusive of notes payable to stockholders, equaling $242,954.59, we cannot find petitioner's interest in Rockland Radio, whether debt or capital, to be worthless at that time.

Petitioner seeks further objective support for 1966 worthlessness from the fact that even with the improved radio signal installed in the spring of 1966, advertising and operations in general were still not profitable during the last four peak months of 1966.[2/] We agree with

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2/ Such a result is not surprising since Rockland Radio had no sales manager for the months of July, August and September 1966.

petitioner that he is not required to be an "incorrigible optimist," United States v. S. S. White Dental Manufacturing Co., 274 U.S. 398 (1927), but in the same vein, requiring clearly identifiable events discourages the premature pessimist. Petitioner provi'ed the financial backing for Rockland Radio and its attitude toward future profitability was reflected in his acts. His continuous and sizeable advances are wholly inconsistent with worthlessness in 1966. Based upon our decision in William Purvin, 6 T.C. 21 (1946), petitioner urges that dealings between a creditor and debtor subsequent to the year of claimed worthlessness do not negate the loss. William Purvin is clearly distinguishable because Purvin "made advancements in connection with a

wholly different venture in a later year * * *." Purvin at 29. On the other hand, as we stated in Richard R. Riss, Sr., supra at 408:

> Generally speaking, where a business, though faltering markedly, has been able to perpetuate itself as a going concern, the courts have been reluctant to hold that its debts during such a period of decline were so irredeemable as to be considered worthles. See, e.g., City National Bank, 11 B.T.A. 857 (1928), appeal dismissed per curiam 35 F.2d 1016 (C.A. 8, 1929); Miriam Coward Pierson, 27 T.C. 330, 339 (1956), affd. 253 F.2d 928 (C.A. 3, 1958); Trinco Industries, Inc., 22 T.C. 959, 965 (1954); and Frank J. Shippen, supra. Even where the assets of such a business were so badly outweighed by its liabilities as to render it insolvent, the fact that it was able to struggle on as a viable concern has frequently been enough to preclude a showing of uncollectibleness. W. D. Roussel, 37 T.C. 235, 245 (1961); Miriam Coward Pierson, supra; and Trinco Industries, Inc., supra, wherein the Court held as follows:

> Petitioner has failed to prove the worthlessness * * * of the debt owed to it by its Canadian subsidiary in the taxable year ending June 30, 1950. * * * While losing money, and insolvent to the extent that its liabilities exceeded the book value of its assets, it was still actively engaged in business on June 30, 1950, and continued to operate for more than a year thereafter. Evidence of insolvency based on book figures does not necessarily establish the worthlessness of debts.* * * [22 T.C. at 965.]

> In our opinion, like the facts of many of the cases cited above, the facts of the within proceeding--though compelling--are not sufficient to warrant the result sought by petitioner.

Petitioner seeks to offset the inferences of potential value accompanying the advances by explaining that he feared he would lose "everything" if Rockland Radio's creditors foreclosed. We question the despair accompanying such an explana-

tion when petitioner flatly rejected the unsolicited offer to purchase the station's assets within three months of when a sale would have been permitted under FCC regulations.

We have not been directed to any circumstances indicating an identifiable event in 1967. To the contrary, Rockland Radio employed a new sales manager on January 1, 1968, and, discounting the "puffing-up" which accompanies a loan request, it cannot be denied that petitioner and, consequently, Rockland Radio were confident in his ability and the likelihood of profitable operations. Therefore, we hold that there were no identifiable events in 1966 or 1967 sufficient to support a loss deduction, whether for worthless stock or for bad debt.

In view of our previous holding that even if the items were debt, they did not become worthless in 1966 or 1967, the Commissioner's failure to allow a deduction for partial worthlessness under section 166(a)(2) was not arbitrary or unreasonable. Frank D. Stranahan, 14 B.T.A. 1405 (1929), affd. 42 F.2d 729 (6th Cir. 1930), cert. denied 283 U.S. 822 (1931)..

As a final alternative contention, petitioner seeks to deduct the cash advances made in each of the taxable years as section 162 ordinary and necessary business expenses of a landlord. Assuming the expenses to be necessary, there is nothing in the record suggesting that payments by a landlord to preserve a tenant which has never been able to pay its rent were common or frequent in the

real estate rental industry. Deputy v. DuPont, 308 U.S. 488 (1940).

Due to other concessions,

Decision will be entered under Rule 155.

UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT

No. 76-1172

Arthur L. Winn, Jr., and
Sadie N. Winn, Appellants,

v.

Commissioner of Internal
Revenue, Appellee.

On Petition for Review of Decision of
the United States Tax Court.

Argued October 5, 1976
Decided November 8, 1976.

Before WINTER, Circuit Judge, FIELD,
Senior Circuit Judge, and HALL, Circuit
Judge.

Paul M. Donovan (Arthur K. Mason on brief)
for Appellants; Libero Marinelli, Jr.,
Attorney, Tax Division, Department of
Justice (Scott P. Crampton, Assistant
Attorney General, Gilbert E. Andrews and
Jonathan S. Cohen, Attorneys, Tax Divi-
sion, Department of Justice on brief) for
Appellee.

PER CURIAM:

The United States Tax Court below upheld the Commissioner of the Internal Revenue's disallowance of certain deductions for advances made by the Taxpayer to Rockland Radio Corporation. The Taxpayer contended that the debts became worthless in either 1966, or, alternatively, in 1967, pursuant to Section 166(a)(1) of the Internal Revenue Code, 26 U.S.C. § 166(a)(1). The Taxpayer has appealed, and we affirm.

In this appeal, Taxpayer argues that Rockland Radio Corporation was financially moribund at the end of 1966 even though his personal views at the time may have been to the contrary; accordingly, he submits that the sums advanced by him to the corporation were worthless debts. He

asserts that the Tax Court applied the wrong standard or burden of proof regarding "worthlessness," and that undue emphasis was placed on transactions and events occurring after 1966 and 1967. The Commissioner admits that the debts became worthless in 1970, but not earlier, and contends that through 1967 there was a reasonable hope for success of the radio station.

The Tax Court concluded, and we agree, that the debtor radio station did have liquidation value and potential value in 1966 or 1967 and that no "identifiable events" to the contrary occurred.

The Taxpayer's own conduct, including continual and sizeable cash advances to the debtor corporation, the rejection of an offer for sale of the station, and his

letter to a bank indicating that he hoped that the radio operation would be profitable within a short time, supports the conclusions of The Tax Court.

The Tax Court applied the correct standard to determine worthlessness, or lack thereof, and did not unduly emphasize post 1966 or 1967 conduct of the Taxpayer when analyzing the claims of worthlessness.

We affirm for the reasons carefully set forth by The United States Tax Court in its Memorandum Findings of Fact and Opinion, T.C. Memo., 1975-213, filed June 30, 1975, and the subsequent Order entered September 12, 1975, denying the Taxpayer's motion for a further trial.

The Tax Court decision is

A F F I R M E D.

UNITED STATES COURT OF APPEALS

FOR THE FOURTH CIRCUIT

No. 76-1172

ARTHUR L. WINN, JR., and
SADIE N. WINN, Appellants,

v.

COMMISSIONER OF INTERNAL
REVENUE, Appellee.

On Petition for Review of Decision of
the United States Tax Court.

ORDER DENYING REHEARING

Having carefully considered the appellants' petition for rehearing, with

the concurrence of Judge Winter and Judge Field, the petition is denied.

For the Panel:

s/Judge Hall

United States Circuit Judge

A True Copy, Teste:

William K. Slate, II, Clerk

By s/Faye L. Smith
Deputy Clerk

Supreme Court, U. S.
FILED
MAR 7 1977
MICHAEL RODAK, JR., CLERK

No. 76-975

In the Supreme Court of the United States

OCTOBER TERM, 1976

ARTHUR L. WINN AND SADIE N. WINN, PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

MEMORANDUM FOR THE RESPONDENT IN OPPOSITION

DANIEL M. FRIEDMAN,
Acting Solicitor General,
Department of Justice,
Washington, D.C. 20530.

In the Supreme Court of the United States

OCTOBER TERM, 1976

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ARTHUR L. WINN AND SADIE N. WINN, PETITIONERS

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COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

MEMORANDUM FOR THE RESPONDENT IN OPPOSITION

The question presented in this federal income tax case is whether the decision below correctly held that petitioner's advances to his closely held corporation did not become worthless during 1966 or 1967, so that he was not entitled to bad debt deductions for those years.

The pertinent facts are as follows: In the early 1960's, petitioner[1] and his son decided to establish and operate a radio station in Rockland County, New York. They applied for a broadcast license, formed a corporation known as Rockland Radio Corporation, purchased and leased land, constructed a broadcast studio building, and leased a portion of the land and building to the corporation for

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[1] "Petitioner" refers to Arthur L. Winn. Sadie N. Winn is a party only because she filed joint returns with her husband for the years at issue.

broadcast facilities. The stock ownership of the corporation was as follows: petitioner—25 percent, his son—50 percent, and two Rockland County businessmen—25 percent. Apart from the $24,000 it received upon the issuance of its stock, the corporation borrowed the funds necessary to its operations. It borrowed $75,000 from a bank and received $51,000 in advances from petitioner through the close of 1965 (Pet. App. 2-8).

Rockland Radio commenced operations in September, 1965. It lost approximately $100,000 in 1965, and continued to lose money at the rate of $100,000 a year until operations ended toward the end of 1970. In order to sustain operations in 1966, petitioner advanced Rockland Radio an additional $100,000. Its 1966 balance sheet showed assets of $145,000 and liabilities of $370,000. Rockland Radio's liabilities thereafter increased by about $100,000 a year. In 1967, petitioner borrowed $10,000 from a friend and $74,000 from his son's mother-in-law, and he advanced those amounts to the corporation. In a last-ditch attempt to save the radio station in 1968, petitioner hired a new manager, changed the station's format, and advanced additional funds he obtained from borrowing. In July, 1968, petitioner rejected a $350,000 purchase offer for the station, believing that the radio station would turn profitable by September (Pet. App. 12, 14-19).

On his 1966 income tax return, petitioner claimed the $151,000 he advanced to Rockland Radio through 1966 as a bad debt deduction, and the unused part of that deduction as net operating loss carryback for 1963 and a loss carryover for 1967. On audit, the Commissioner of Internal Revenue disallowed the deduction on various grounds, including petitioner's failure to establish that the advances did not become worthless in 1966. In the Tax Court, petitioner asserted that, if the advances did

not become worthless in 1966, they became so in 1967. The Tax Court held that petitioner had not established that the advances became worthless in either 1966 or 1967 (Pet. App. 29-30). The court of appeals affirmed *per curiam* (Pet. App. 32-35).

Section 166(a) of the Internal Revenue Code (26 U.S.C.) permits a deduction for debts which become worthless within the tax year. As in the case of any loss deduction, the taxpayer must establish that the debt became worthless in the year for which he claims the deduction. *Wilson* v. *United States,* 376 F. 2d 280, 291 (Ct. Cl.). Debts may have two kinds of value. One is liquidation value, *i.e.,* the value derived from the excess of the debtor's assets over his liabilities. *Steadman* v. *Commissioner,* 50 T.C. 369, 376, affirmed, 424 F. 2d 1 (C.A. 6), certiorari denied, 400 U.S. 869.

The second type of value is potential value, which is measured by the reasonable expectation that the debtor, though perhaps currently insolvent, will eventually be able to repay his obligations. *Riss* v. *Commissioner,* 478 F. 2d 1160, 1166 (C.A. 8); *Steadman* v. *Commissioner, supra,* 43 T.C. at 376. The absence of potential value is most often established by an "identifiable event," such as bankruptcy, which eliminates the debtor's ability to make repayment. *Messer* v. *Commissioner,* 57 T.C. 848, 861; *Morton* v. *Commissioner,* 38 B.T.A. 1270, 1278, affirmed, 112 F. 2d 320 (C.A. 7). In other instances, the absence of potential value may be shown by so bleak an economic outlook that the possibility of recovery is as remote as it would be upon the occurrence of an identifiable event. *Steadman* v. *Commissioner, supra,* 43 T.C. at 377; *Morton* v. *Commissioner, supra,* 38 B.T.A. at 1278.

Here, the Tax Court found that petitioner's advances to Rockland Radio Corporation had both liquidation and

potential value in 1966 and 1967 (Pet. App. 23-27). In support of this finding, the court pointed to the absence of an identifiable event in 1966 or 1967 that made repayment impossible (Pet. App. 23, 27) and the facts that Rockland Radio continued its operations into 1970, that petitioner made sizeable advances to the corporation in 1967 and 1968, that petitioner rejected a $350,000 offer for the sale of the station in 1968, and that in 1968 petitioner represented to lender banks that he expected the station to become profitable in the near future (Pet. App. 24, 26, 29).

Petitioner contends (Pet. 7-11) that the decision below improperly relied upon his subjective hopes for recovery of the advances. In his view, a determination of value cannot be based on the taxpayer's hopes but must rest on objective facts supporting a reasonable prospect for recovery. But the decision below does not turn on petitioner's subjective thoughts but on his objective actions.

The actions of the parties may be taken into account in appraising the economic condition of a debtor and the value of claims against him. Thus, for example, the courts have frequently found a lender's extension of additional credit or forbearance in requiring repayment to be highly persuasive as to the existence of potential value. See, *e.g., Riss* v. *Commissioner,* 56 T.C. 388, 408, affirmed, 478 F. 2d 1160 (C.A. 8); *Trinco Industries, Inc.* v. *Commissioner,* 22 T.C. 959, 965. Here, petitioner provided additional credit to Rockland Radio in order to continue its operations into 1970. Moreover, in 1968, he rejected a substantial offer to purchase the station. Under these circumstances, the decision below correctly held that petitioner had a reasonable expectation of repayment

in both 1966 and 1967. He therefore was not entitled to a bad debt deduction for either of those years.[2]

The petition for a writ of certiorari should be denied.

Respectfully submitted.

DANIEL M. FRIEDMAN,
Acting Solicitor General.

MARCH 1977.

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[2]The cases petitioner cites (Pet. 8-10) do not conflict with the decision below. Unlike the situation here, an identifiable event terminating the debtor's future business prospects had occurred in those cases, and the creditor or investor had made no further advances.